

of services.<sup>111</sup> MCI claims that, although some interexchange services may have characteristics indicative of discrete product markets, there is no lack of competitive performance with respect to a particular service or group of services that would warrant the Commission's delineating the boundaries of specific product markets.<sup>112</sup> The Pennsylvania Commission cautions that state commissions and consumer advocacy groups may not have access to the information necessary to determine whether credible evidence exists, especially if the Commission detariffs non-dominant carriers.<sup>113</sup> Sprint states that the Commission should reexamine various product markets if circumstances require.<sup>114</sup>

38. ACTA suggests that a separate relevant market should be established where the Commission finds that a carrier possesses market power over a particular market segment.<sup>115</sup> In delineating product markets, ACTA believes that the Commission should consider many factors including such customer classifications as residential, small/medium businesses, and large businesses, but cautions that product markets based on discrete offerings may not adequately account for products offered as a package of services.<sup>116</sup>

39. Two commenters identify particular services that, they contend, should be classified as separate product markets. The Pennsylvania Commission recommends that the Commission define three separate product markets: (1) MTS or residential long distance; (2) WATS/800 service; and (3) virtual network-type services (all services provided within software defined networks).<sup>117</sup> SNET argues that the Commission should treat interstate toll free directory assistance as a separate product market because there are no substitutes and structural barriers make entry impossible.<sup>118</sup>

### c. Discussion

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<sup>111</sup> MCI April 19, 1996 Comments at 6; GTE May 3, 1996 Reply at 3; TRA April 19, 1996 Comments at 32.

<sup>112</sup> MCI Aug. 15, 1996 Comments at 59.

<sup>113</sup> PaPUC April 19, 1996 Comments at 6-7.

<sup>114</sup> Sprint Aug. 15, 1996 Comments at 60.

<sup>115</sup> ACTA April 19, 1996 Comments at 1.

<sup>116</sup> Id. at 2.

<sup>117</sup> PaPUC April 19, 1996 Comments at 7.

<sup>118</sup> SNET April 19, 1996 Comments at 19-20.

40. We conclude that the product market definition adopted in the Competitive Carrier proceeding should be revised to reflect the 1992 Merger Guidelines' approach to defining relevant markets.<sup>119</sup> As explained above, we find that this new approach to defining the relevant product market will provide us with a more refined and narrowly-focused tool that more accurately reflects marketplace realities. We, therefore, adopt our tentative conclusion in the Interexchange NPRM that we should define as a relevant product market any interstate, domestic, long distance service for which there are no close demand substitutes, or a group of services that are close substitutes for each other, but for which there are no other close demand substitutes.<sup>120</sup> We also adopt our tentative conclusion that we need not delineate the boundaries of specific product markets, except where there is credible evidence suggesting that there is or could be a lack of competitive performance with respect to a particular service or group of services.

41. Unlike the approach to product market definition adopted in the Competitive Carrier proceeding, our new approach will rely exclusively on demand considerations to define the relevant product market, rather than supply substitutability.<sup>121</sup> As discussed above, supply substitutability will continue to be a relevant factor in assessing market power, but will not be used as a factor in defining the relevant market.<sup>122</sup> Although this distinction may be subtle, we believe that it is important in order to ensure that each step we take in assessing market power is grounded in fundamental economic principles and marketplace realities. Our new approach, however, does not reflect an "all-services" methodology of assessing dominance, in which a carrier must be deemed dominant with respect to all services if it is found to have market power over any single service. Rather, our new approach allows us, where warranted, to focus our analysis on particular services and limit our assessment of market power with regard to only those particular services.

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<sup>119</sup> The 1992 Merger Guidelines define the relevant product market as "a product or group of products such that a hypothetical profit maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price." Accordingly, in defining the relevant product market, one must examine whether a "small but significant and nontransitory" increase in the price of the relevant product would cause enough buyers to shift their purchases to a second product, so as to make the price increase unprofitable. If so, the two products should be considered in the same product market. 1992 Merger Guidelines at p. 20,572.

<sup>120</sup> As previously noted, demand substitutability identifies all of the products or services that consumers view as substitutes for each other, in response to changes in price.

<sup>121</sup> As previously noted, supply substitutability identifies all productive capacity that can be used to produce a particular good, whether it is currently being used to produce that good or to produce some other, even unrelated, good.

<sup>122</sup> We disagree with USTA that our approach to defining the relevant market in the international services market is inconsistent with our approach in the domestic context. See discussion infra at ¶¶ 53, 80.

42. We further adopt our tentative conclusion that we need not delineate any particular product markets to analyze the market power of a particular carrier or group of carriers unless there is credible evidence suggesting that there is or could be a lack of competitive performance with respect to a particular service or group of services.<sup>123</sup> We recognize that the various services available in the interstate, domestic, long distance marketplace are changing.<sup>124</sup> Patterns of consumer demand and the forces of competition spur continual innovation and force carriers constantly to reevaluate current services, remove outdated services, and add new services to the marketplace. In light of these marketplace dynamics, we conclude it is best to establish a consistent approach to defining the relevant product market that maintains the flexibility to recognize separate product markets only when there is credible evidence indicating that there is or could be a lack of competitive performance with respect to a particular service or group of services.

43. Despite two commenters' recommendations that we identify for all purposes, in this proceeding, particular services as separate product markets, we decline to do so at this time.<sup>125</sup> We conclude that such a determination should only be made in the context of assessing the market power of a particular carrier or group of carriers.<sup>126</sup> Unless there is credible evidence suggesting that there is or could be a lack of competitive performance with respect to a particular service or group of services, we will treat these services together, by analyzing aggregate data that encompasses all long distance services, rather than information particular to specific services.<sup>127</sup> Recognizing that we have previously found that there is substantial competition with respect to most interstate, long distance services, such an approach allows us to avoid the burdensome task of delineating separate product markets

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<sup>123</sup> For example, if the price/cost ratio for a particular interexchange service is four times that of the price/cost ratio for all other interexchange services, that may constitute credible evidence of a lack of competitive performance.

<sup>124</sup> For example, we noted in the Interexchange NPRM that "our finding [in the AT&T Reclassification Order] that the prices of 800 directory assistance and analog private line services could profitably be raised above competitive levels may imply these services constitute distinct relevant product markets." Interexchange NPRM, 11 FCC Rcd at 7166, ¶ 44.

<sup>125</sup> PaPUC April 19, 1996 Comments at 7; SNET April 19, 1996 Comments at 19-20.

<sup>126</sup> In this proceeding, we only assess the market power of BOC interLATA affiliates and independent LECs. As noted supra at ¶ 29, any modifications that we may make to decisions reached in the AT&T Reclassification Order will be addressed, as necessary, in further proceedings. We emphasize, however, that because market definition is only one step in assessing market power, changes made in the approach to defining relevant markets will not necessarily produce different assessments of market power.

<sup>127</sup> Such data may include, but not be limited to, price level of services, the number of competitors, the share of sales by competitors, and the ease with which potential entrants can provide these services.

when there is no other credible evidence suggesting that a particular carrier or group of carriers is exercising or has the ability to exercise market power, with respect to a particular service or group of services. Therefore, we will refrain from examining narrower relevant product markets except when such credible evidence has come to our attention.<sup>128</sup>

44. We conclude that the approach we adopt here will not impose an undue burden on parties seeking to have the Commission define narrower relevant product markets in order to assess the market power of a particular carrier or group of carriers. Such parties will not have to prove that there is an actual lack of competitive performance with respect to a particular service or group of services. Rather, they must only present credible evidence that there is or could be a lack of competitive performance.<sup>129</sup> Credible evidence should include information sufficient to identify services that are likely substitutes and the carrier or group of carriers that allegedly possesses market power. Contrary to the concerns of the Pennsylvania Public Utilities Commission, because information suggesting a lack of competitive performance, such as availability of service from a single provider, is easily observable, we need not require data from proprietary sources for this purpose. Moreover, as we recognized in the Tariff Forbearance Order, even in the absence of tariffs for interstate, domestic, interexchange services offered by non-dominant carriers, we conclude that information concerning the rates, terms and conditions for such services will still be readily accessible to consumers and other interested parties because customers will continue to receive this information through, inter alia, the billing process, notifications required by service contracts or state consumer protection laws, and marketing materials, such as advertisements.<sup>130</sup>

## 2. Product Market Definition for BOC InterLATA Affiliates and Independent LECs

### a. Background

45. In the Non-Accounting Safeguards NPRM, we tentatively concluded that if we adopt the market definition approach proposed in the Interexchange NPRM, we should treat all interstate, domestic, long distance services as the relevant product market for purposes of

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<sup>128</sup> As we conclude infra at ¶ 50, for purposes of assessing the market power of BOC interLATA affiliates and independent LECs in their provision of domestic, interstate, long distance services, we need not delineate separate product markets because there is no credible evidence in the record that indicates that there is or will be a lack of competitive performance associated with any particular long distance service offered by BOC interLATA affiliates or independent LECs.

<sup>129</sup> PaPUC April 19, 1996 Comments at 6.

<sup>130</sup> See Tariff Forbearance Order at ¶ 25.

determining whether BOC interLATA affiliates have market power in their provision of in-region domestic, interstate, interLATA services and whether independent LECs have market power in their provision of in-region domestic, interstate, interexchange services.<sup>131</sup>

b. Comments

46. Although commenters disagree over whether the Commission should adopt the approach to the product market definition proposed in the Interexchange NPRM, most commenters agree with the Commission's tentative conclusion in the Non-Accounting Safeguards NPRM that interstate, domestic, long distance services should be treated as a single product market for purposes of assessing whether BOC interLATA affiliates and independent LECs have market power.<sup>132</sup>

47. AT&T argues that the interexchange product market definition is irrelevant to whether the BOCs could abuse their power in the local market to impede interexchange competition. Instead, AT&T contends that the proper markets to analyze are the local exchange and exchange access service markets, rather than the interexchange market.<sup>133</sup> DOJ also argues that the product market definition is irrelevant to whether BOC interLATA affiliates could exercise market power in the interLATA marketplace because BOC interLATA affiliates clearly do not have the ability to raise prices by restricting output.<sup>134</sup>

48. BellSouth contends that since the Commission did not redefine the product market in order to evaluate whether AT&T was a dominant carrier, it need not reconsider the definition in order to evaluate the competitive effects of BOC entry into the interexchange market.<sup>135</sup> USTA and GTE agree with the Commission's tentative conclusion that all interstate, domestic, interexchange services should be considered the relevant product market for independent LECs.<sup>136</sup>

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<sup>131</sup> Non-Accounting Safeguards NPRM at ¶ 119.

<sup>132</sup> See e.g., BellSouth Aug. 15, 1996 Comments at 40-41; Sprint Aug. 15, 1996 Comments at 60; TRA Aug. 15, 1996 Comments at 24; USTA Aug. 15, 1996 Comments at 40-41; MCI Aug. 15, 1996 Comments at 58-59.

<sup>133</sup> AT&T Aug. 15, 1996 Comments at 61-62.

<sup>134</sup> DOJ Aug. 30, 1996 Reply at 17.

<sup>135</sup> BellSouth April 19, 1996 Comments at 12-13.

<sup>136</sup> USTA Aug. 29, 1996 Comments (Spulber Aff. at 5); GTE Aug. 29, 1996 Comments at 7.

49. The Independent Telephone Telecommunications Alliance (ITTA) contends that the Commission should adopt a product market defined as "all telecommunications services," that encompasses such services as interexchange, local, access and wireless services, in recognition of the new market structure envisioned by the 1996 Act in which firms will be providing a broad range of services.<sup>137</sup> The Competitive Telecommunications Association (CTA) contends that the relevant product market should include those services that rely on or utilize the BOCs' local network.<sup>138</sup>

**c. Discussion**

50. We are aware of no evidence, nor has any commenter presented any such evidence in the record, that suggests that there is a particular interexchange service or group of services that will be provided by BOC interLATA affiliates or independent LECs with respect to which there is or could be a lack of competitive performance. Moreover, we have found previously that there is substantial competition with respect to most interstate, domestic, interexchange service offerings.<sup>139</sup> As a result, we conclude that we need not conduct any particularized product market inquiry in order to evaluate the market power of BOC interLATA affiliates and independent LECs for interexchange services. We conclude that, at this time and for purposes of determining whether BOC interLATA affiliates or independent LECs have market power in the provision of domestic, interstate, long distance services, our assessment of market power will remain the same, regardless of whether we examine each individual long distance service, different groupings of long distance services, or aggregate data that encompasses all long distance services. Therefore, in assessing the market power of BOC interLATA affiliates and independent LECs in the provision of domestic, interstate, long distance services, we find it is appropriate at this time to evaluate their market power with respect to all interstate, domestic, long distance services, rather than conducting a separate analysis of each individual service.

51. We disagree with AT&T's assertion that the product market definition is irrelevant in assessing whether BOC interLATA affiliates or independent LECs possess market power in the domestic, interstate, long distance market. As discussed above, we believe that a relevant product market must be defined before we can evaluate whether a particular carrier or group of carriers possesses market power. While we agree with AT&T that other factors are important in making our overall assessment of market power, we conclude that we must define the relevant product market in order to reach an accurate

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<sup>137</sup> ITTA Aug. 29, 1996 Comments at 6-9.

<sup>138</sup> CTA Aug. 15, 1996 Comments at 33.

<sup>139</sup> See AT&T Reclassification Order, 11 FCC Rcd at 3309-35, ¶¶ 74-116.

assessment of whether BOC interLATA affiliates or independent LECs possess market power in the domestic, interstate, long distance marketplace.

**3. International Product Market for BOC InterLATA Affiliates and Independent LECs**

52. In the Non-Accounting Safeguards NPRM, we tentatively concluded that we should apply the current international product market definition, which recognizes international message telephone service (IMTS) and non-IMTS as separate product markets, for purposes of determining whether BOC interLATA affiliates and independent LECs possess market power in the provision of international long distance services.<sup>140</sup>

53. MCI and NYNEX generally agree with the Commission's tentative conclusion that IMTS and non-IMTS should be treated as the relevant product markets for international services.<sup>141</sup> USTA supports treating international services as a product market separate from domestic services, because international agreements and regulation create different conditions than exist for domestic interexchange services.<sup>142</sup> Questioning the wisdom of dividing international services into two distinct product markets, Sprint argues that the Commission should retain flexibility to reflect the rapid changes taking place in the product market for international communications.<sup>143</sup> Sprint asserts, for example, that, where providers engage in the resale of international private lines interconnected to the public switched network at both ends, the distinctions between IMTS and non-IMTS are blurred.<sup>144</sup>

54. We conclude that, for purposes of determining whether BOC interLATA affiliates and independent LECs possess market power in the provision of international long distance services, we will modify our tentative conclusion and examine aggregate data that encompasses all international long distance services. Because our approach to defining relevant markets is based on fundamental economic principles, we find that it is applicable for assessing market power in both the domestic and international long distance markets. Although we recognize that international agreements and regulation distinguish international long distance service from domestic long distance service, we conclude that, while these distinctions may affect our assessments of market power, they do not change our approach to

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<sup>140</sup> Non-Accounting Safeguards NPRM at ¶ 121.

<sup>141</sup> MCI Aug. 15, 1996 Comments at 58-60; NYNEX Aug. 15, 1996 Comments at 61.

<sup>142</sup> USTA Aug. 15, 1996 Comments (Hausman Aff. at 5-6).

<sup>143</sup> Sprint Aug. 15, 1996 Comments at 61.

<sup>144</sup> Sprint Aug. 15, 1996 Comments at 60-61.

defining relevant markets. Therefore, we find that we should define the relevant product market, in the international context, as any international long distance service for which there are no close substitutes or a group of services that are close substitutes for each other, but for which there are no other close substitutes. We need only delineate specific product markets, however, when there is credible evidence suggesting that there is or could be a lack of competitive performance with respect to a particular service or group of services.

55. Although traditionally we have recognized IMTS and non-IMTS as separate international long distance product markets, we conclude, similar to our conclusion in the domestic context, that this distinction is not necessary for purposes of assessing whether BOC interLATA affiliates and independent LECs possess market power in the international long distance marketplace in this Order because our assessment of market power will not change whether we examine IMTS and non-IMTS separately as individual product markets or analyze aggregate data that encompasses both IMTS and non-IMTS. Our decision to analyze aggregate data that encompasses IMTS and non-IMTS, in this particular context, does not modify our treatment of IMTS and non-IMTS as separate product markets under the existing framework for regulating U.S. carriers as dominant in the provision of international services because of the market power of an affiliated foreign carrier.<sup>145</sup>

### C. Geographic Market

#### 1. Geographic Market in General

##### a. Background

56. In the Competitive Carrier proceeding, the Commission defined the relevant geographic market as "the United States (including Alaska, Hawaii, Puerto Rico, U.S. Virgin Islands, and other U.S. offshore points) . . . with no relevant submarkets."<sup>146</sup> In the Interexchange NPRM, the Commission tentatively concluded that we should refine this analysis and define a relevant geographic market for interstate, domestic, interexchange services as all calls, in the relevant product market, between two particular points.<sup>147</sup> For purposes of market power analysis, however, the Commission tentatively concluded that, in general, we should treat domestic, interstate, interexchange calling as a single, national market because geographic rate averaging, in conjunction with the pervasiveness of ubiquitous calling plans, should reduce the likelihood that a carrier could exercise market

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<sup>145</sup> See n. 21 *supra*.

<sup>146</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 563, ¶ 13.

<sup>147</sup> Interexchange NPRM 11 FCC Rcd at 7165, 7167-68, ¶¶ 42, 49.



power in a single point-to-point market, and because price regulation of access services and excess capacity in interstate transport should reduce the likelihood that an interexchange carrier could exercise market power in most point-to-point markets.<sup>148</sup> If there is credible evidence suggesting that there is or could be a lack of competition in a particular point-to-point market or group of point-to-point markets and there is a showing that geographic rate averaging will not sufficiently mitigate the exercise of market power in that market or group of markets, we proposed to examine the individual market or group of markets for the presence of market power.<sup>149</sup> We asked commenters to evaluate this new approach and to suggest any other possible approaches.<sup>150</sup>

**b. Comments**

57. Many commenters oppose the Commission's proposal to define a relevant geographic market for interstate, domestic, interexchange services as all calls between two points, although some commenters concede its conceptual validity.<sup>151</sup> Those parties opposing the point-to-point market definition generally advocate the retention of the single national market definition adopted in the Competitive Carrier proceeding. Several commenters claim that demand patterns based on the widespread use of ubiquitous calling plans favor a national market.<sup>152</sup> Other commenters indicate that it may be too early to define relevant geographic markets with lasting precision and that point-to-point markets would not be administrably viable because of the impracticality of conducting a market power analysis in each point-to-point market.<sup>153</sup> A number of parties support our proposal to treat interstate, interexchange calling as a single national market unless there is credible evidence suggesting that there is or could be a lack of competition in a particular point-to-point or group of point-to-point markets, and there is a showing that geographic rate averaging will not sufficiently mitigate

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<sup>148</sup> Id. at 7168-70, ¶¶ 51-52.

<sup>149</sup> Id. at 7170, ¶ 53.

<sup>150</sup> Id. at 7170-71, ¶¶ 54-55.

<sup>151</sup> See e.g., BellSouth April 19, 1996 Comments at 16-20; Florida PSC April 19, 1996 Comments at 7.

<sup>152</sup> AT&T April 19, 1996 Comments at 19 (citing Competitive Carrier Fourth Report and Order, 95 FCC 2d at 574); BellSouth May 3, 1996 Reply at 4; Florida PSC April 19, 1996 Comments at 8-9; USTA Aug. 15, 1996 Comments at 43; PacTel Aug. 15, 1996 Comments at 51; NYNEX Aug. 15, 1996 Comments at 52-54.

<sup>153</sup> ACTA April 19, 1996 Comments at 6-7; USTA Aug. 15, 1996 Comments at 43 (Hausman Aff. at 6-7); DOJ Aug. 30, 1996 Reply at 19.

the exercise of market power.<sup>154</sup>

58. AT&T disagrees with the Commission's point-to-point market analysis and argues that a single national market definition reflects the way that competitors have built and conducted their business.<sup>155</sup> AT&T also notes that the Commission has rejected point-to-point markets on several previous occasions.<sup>156</sup> AT&T, BellSouth, USTA and NYNEX emphasize that supply substitutability demonstrates that the market is national because several carriers have national networks with capacity to provide alternate routing and the ease of constructing new facilities or to resell services allows carriers to enter the market and expand service rapidly.<sup>157</sup>

59. Several commenters contend that the geographic rate averaging and rate integration requirements in the 1996 Act and the regulatory regime overseeing access rates point to the existence of a single, national market because together they ensure that the benefits of competition in one market will be passed on to customers in other markets.<sup>158</sup> Bell Atlantic supports a single national market because, as long as customers select a carrier for nationwide coverage, national pricing schemes will drive the market, whether or not certain carriers offer services originating only in a particular region.<sup>159</sup> PacTel claims that the trend toward uniform, distance-insensitive pricing demonstrates that the interexchange market remains a national one.<sup>160</sup> USTA asserts that if point-to-point markets are appropriate, AT&T should not have been classified as a non-dominant interexchange carrier

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<sup>154</sup> See e.g., Ameritech April 19, 1996 Comments at 13; SBC April 19, 1996 Comments at 4-5; GTE April 19, 1996 Comments at 5, May 3, 1996 Reply at 3; MCI April 19, 1996 Comments at 6; LDDS Aug. 15, 1996 Comments at 4-7; TRA April 19, 1996 Comments at 31-32

<sup>155</sup> AT&T April 19, 1996 Comments at 18-21.

<sup>156</sup> AT&T May 3, 1996 Reply at 6-7 (citing Competitive Carrier Fourth Report and Order, 95 FCC 2d at 573-74; Application of MCI Communications Corp. & S. Pac. Telecommunications Corp. for Consent to Transfer Control of Quest Communications, Inc., Memorandum Opinion and Order, 10 FCC Rcd 1072, 1075 (1994)).

<sup>157</sup> AT&T April 19, 1996 Comments at 19-20; BellSouth May 3, 1996 Reply at 4; NYNEX Aug. 15, 1996 Comments at 53.

<sup>158</sup> Ameritech April 19, 1996 Comments at 13; BellSouth April 19, 1996 Comments at 17-18; PacTel April 19, 1996 Comments at 5-8.

<sup>159</sup> Bell Atlantic April 19, 1996 Comments at 6-7.

<sup>160</sup> PacTel April 19, 1996 Comments at 5-6.

because it is the sole carrier serving a number of different cities.<sup>161</sup>

60. PacTel and GTE submit that a single nationwide geographic market is supported by economic theory, Commission precedent, the AT&T Reclassification Order, and the 1996 Act.<sup>162</sup> GTE acknowledges, however, that certain service providers may be able to take advantage of their market power in some point-to-point markets, despite geographic rate averaging, regulated access pricing and excess transmission capacity. In such situations, GTE recognizes that a narrower geographic market may be appropriate to measure market power if there is credible evidence of a lack of competition in a particular market.<sup>163</sup> GTE adds that, if the Commission does adopt a point-to-point approach, this analysis should apply to IXC's as well as LEC's.<sup>164</sup>

61. Ameritech does not oppose the possibility of identifying smaller markets than the national market, but claims that it is unable to identify any such markets at this time.<sup>165</sup> DOJ acknowledges that the relevant geographic market theoretically could be defined as all calls between two particular points, but argues that examining markets at such a level of detail would be impractical.<sup>166</sup>

62. LDDS claims that, although, for most purposes, the appropriate relevant geographic market for interstate, interexchange services is national, the division between local and long distance will blur as competition develops in the local market and the Commission must be able to employ an appropriate geographic market definition to reflect these changes.<sup>167</sup> ACTA and GCI oppose the Commission's proposal to treat interstate, interexchange services generally as a single national market.<sup>168</sup> According to ACTA, such a definition would overlook route-specific pricing schemes designed to defeat competitive

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<sup>161</sup> USTA Aug. 15, 1996 Comments at 43 n. 17.

<sup>162</sup> GTE Aug. 29, 1996 Comments at 8; PacTel April 19, 1996 Comments at 5.

<sup>163</sup> GTE April 19, 1996 Comments at 5, May 3, 1996 Reply at 4; GTE Aug. 29, 1996 Comments at 8.

<sup>164</sup> GTE May 3, 1996 Reply at 5; GTE Aug. 29, 1996 Comments at 8.

<sup>165</sup> Ameritech April 19, 1996 Comments at ii.

<sup>166</sup> DOJ Aug. 30, 1996 Reply at 19.

<sup>167</sup> LDDS April 19, 1996 Comments at 4-5.

<sup>168</sup> ACTA April 19, 1996 Comments at 4; GCI April 19, 1996 Comments at 3-4.

entry.<sup>169</sup> GCI argues that certain obvious characteristics, such as a *de facto* or *de jure* monopoly in the provision of a service or a shortage of capacity in interstate transport, should provide adequate justification for examining a particular market for the presence of market power.<sup>170</sup> GCI cites AT&T/Alascom's facilities monopoly in rural Alaska and the limited fiber optic capacity linking Alaska to the continental United States as such examples.<sup>171</sup>

63. A few commenters propose alternative approaches for defining relevant geographic markets, including markets based on state boundaries or local exchange boundaries and markets based on Metropolitan Statistical Areas (MSAs), Basic Trading Areas (BTAs) or Major Trading Areas (MTAs).<sup>172</sup> GCI asserts that, because market power does not follow any preestablished lines, the Commission should conduct a market power analysis for any area for which there is a nonfrivolous allegation of market power.<sup>173</sup>

### c. Discussion

64. We conclude that the geographic market definition adopted in the Competitive Carrier proceeding should be revised to reflect the approach to defining relevant markets contained in the 1992 Merger Guidelines.<sup>174</sup> In accordance with the principles enunciated in

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<sup>169</sup> ACTA April 19, 1996 Comments at 4.

<sup>170</sup> GCI April 19, 1996 Comments at 3-4.

<sup>171</sup> Id. at 3-4.

<sup>172</sup> See, e.g., Frontier April 19, 1996 Comments at 1-2; PaPUC April 19, 1996 Comments at 10-11; Missouri Public Counsel May 3, 1996 Reply at 3. We note that Rand McNally & Company is the copyright owner of the Basic Trading and Major Trading Area Listings, which list the counties contained in each BTA, as embodied in Rand McNally's Trading Area System Diskette and Atlas & Marketing Guide. Rand McNally has licensed the use of its copyrighted MTA/BTA listings and maps for certain wireless telecommunications services. See Amendment of Parts 2 and 90 of the Commission's Rules to Provide for the Use of 200 Channels Outside the Designated Filing Areas in the 896-901 MHz and the 935-940 MHz Bands Allotted to the Specialized Mobile Radio Pool, PR Docket No. 89-553, Second Report and Order and Second Further Notice of Proposed Rulemaking, 10 FCC Rcd 6884, 6895-96 (1995).

<sup>173</sup> GCI April 19, 1996 Comments at 3-4; GCI May 3, 1996 Reply at 2.

<sup>174</sup> The 1992 Merger Guidelines define the relevant geographic market as the "region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a 'small but significant and nontransitory' increase in price, holding constant the terms of sale for all products produced elsewhere." Accordingly, in defining the relevant geographic market, one must examine whether a "small but significant and nontransitory" increase in the price of the relevant product at a particular location would cause a buyer to shift his purchase to a second location, so

the 1992 Merger Guidelines, we believe that long distance calling, at its most fundamental level, involves a customer making a connection from one specific location to another specific location. As we stated in the Interexchange NPRM, "[w]e believe that most telephone customers do not view interexchange calls originating in different locations to be close substitutes for each other." Therefore, we further conclude that we will follow the revised approach to the geographic market definition proposed in the Interexchange NPRM and define a relevant geographic market for interstate, domestic, long distance services as all possible routes that allow for a connection from one particular location to another particular location (*i.e.*, a point-to-point market).

65. Contrary to a number of commenters, we find that defining the relevant geographic market as a point-to-point market, rather than as a single national market, more accurately reflects the fact that most customers use long distance services by purchasing ubiquitous calling plans. A point-to-point connection is a constituent element of all types of interstate, domestic, long distance services,<sup>175</sup> including purely point-to-point services,<sup>176</sup> as well as point-to-all-points services<sup>177</sup> and all-points-to-point services.<sup>178</sup> Ubiquitous calling plans encompass point-to-all-points services or all-points-to-point services, which are essentially a bundle of point-to-point connections serving a common point. Although ubiquitous calling allows customers to make multiple point-to-point connections from or to a common point via a single source, it does not change the nature of interstate, domestic, long distance calling. From the customer's perspective, while the calling plan itself may be "ubiquitous" in that it offers nationwide coverage from or to a common point, the market to purchase that plan is a localized market, not a national one. For example, customers located in Miami generally purchase calling plans that offer long distance service originating from Miami. Any calling plan that provides service originating from Los Angeles, even if it is "ubiquitous" service, would not be a viable substitute for customers located in Miami.

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as to make the price increase unprofitable. If so, the two locations should be considered to be in the same geographic market. 1992 Merger Guidelines at pp. 20,573 - 20,573-3.

<sup>175</sup> As we described in the Interexchange NPRM, "residential interexchange services can be thought of as a bundle of all possible interexchange calls originating from a single point and terminating anywhere, and 800 service as a bundle of interstate, interexchange calls originating from a certain geographic region and terminating at a specific point." Interexchange NPRM, 11 FCC Rcd at 7168, ¶ 50.

<sup>176</sup> Private line service is an example of a point-to-point service.

<sup>177</sup> Residential long distance service is an example of a point-to-all-points service. Point-to-all-points services can be viewed as a bundle of point-to-point connections all originating at the same point.

<sup>178</sup> Toll free 800 or 888 numbers that are accessible from all domestic geographic locations would be examples of an all points-to-point service. An all-points-to-point service can be viewed as a bundle of point-to-point connections that all terminate at the same point.

Accordingly, we believe that defining the relevant geographic market as a point-to-point market is a more accurate approach to assessing market power than a single national market definition, even assuming that most long distance customers purchase ubiquitous calling plans.

66. We recognize, however, that assessing market power in each individual point-to-point market would be administratively impractical and inefficient. Therefore, we clarify our proposal in the Interexchange NPRM to treat, in general, interstate, long distance calling as a single national market unless there is credible evidence indicating that there is or could be a lack of competition in a particular point-to-point market, and there is a showing that geographic rate averaging will not sufficiently mitigate the exercise of market power. We conclude that when a group of point-to-point markets exhibit sufficiently similar competitive characteristics (*i.e.*, market structure), we will examine that group of markets using aggregate data that encompasses all point-to-point markets in the relevant area, rather than examine each individual point-to-point market separately. Therefore, if we conclude that the competitive conditions for a particular service in any point-to-point market are sufficiently representative of the competitive conditions for that service in all other domestic point-to-point markets, then we will examine aggregate data, rather than data particular to each domestic point-to-point market.<sup>179</sup> Such a finding would require that there be no credible evidence that there is or could be a lack of competitive performance in any point-to-point market for that service. As noted in the Interexchange NPRM, we believe that geographic rate averaging, price regulation of exchange access services, and the excess capacity in interstate transport currently cause carriers to behave similarly in each domestic point-to-point market and reduce the likelihood that carriers could exercise market power in most point-to-point markets.<sup>180</sup>

67. Unless there is credible evidence suggesting that there is or could be a lack of competition in a particular point-to-point market or group of point-to-point markets, and there is a showing that geographic rate averaging will not sufficiently mitigate the exercise of market power, we will refrain from employing the more burdensome approach of analyzing separate data from each point-to-point market. We believe that, in most cases, statistics, such as market shares, are most usefully calculated based on aggregate data covering all domestic point-to-point markets.<sup>181</sup>

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<sup>179</sup> For example, we could analyze national market share data, rather than market share data for particular point-to-point markets.

<sup>180</sup> Interexchange NPRM, 11 FCC Rcd at 7168-70, ¶¶ 51-52.

<sup>181</sup> In many point-to-point markets (*e.g.*, one home to another home), one long distance carrier will have 100 percent market share. This does not imply, however, that this particular long distance carrier has market power. Therefore, in using market share as one factor in assessing market power, it is important that we

68. In the Interexchange NPRM, we also sought comment on how narrowly we should define the points of origination and termination when examining a point-to-point market.<sup>182</sup> The relevant point in a point-to-point market is the location of a particular telephone or other telecommunications device. For example, with regard to residential long distance service, the relevant point is each individual customer's residence. We recognize that assessing market power at such a level of detail would be administratively impractical. We conclude, however, that there is no need to define larger points because, when assessing the market power of a particular carrier or group of carriers, we will treat together all point-to-point markets within a boundary such that all transactions carried out within that boundary are subject to the same competitive conditions. Therefore, for all practical purposes, we fully expect that the relevant geographic area for assessing market power will usually consist of multiple point-to-point connections that exhibit the same competitive conditions. Because we will invariably analyze a group of point-to-point markets, there is no practical need to also redefine the individual points.

69. Although GCI has suggested that we treat Alaska as a separate geographic market in assessing the market power of AT&T/Alascom, we do not do so in this proceeding.<sup>183</sup> As noted above, any modifications to decisions reached in the AT&T Reclassification Order that may be necessary as a result of our decision here will be addressed, as necessary, in further proceedings.<sup>184</sup> We emphasize, however, that, because market definition is only one step in assessing market power, changes made in the approach to defining relevant markets will not necessarily produce different assessments of market power.

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examine market share in the broadest geographic group of point-to-point markets in which competitive conditions are reasonably homogeneous.

<sup>182</sup> LDDS contends that the Commission should group relevant point-to-point markets according to metropolitan statistical areas because they roughly approximate the geographic area in which buyers can practically turn for alternative sources of supply or in which there are sellers that can act to restrain the prices charged to buyers. LDDS April 19, 1996 Comments at 6-7. NYNEX and GTE assert that none of the geographic areas identified in the Interexchange NPRM, such as local exchange areas, major trading areas, and MSAs, are relevant to the interexchange marketplace. NYNEX April 19, 1996 Comments at 8; GTE April 19, 1996 Comments at 5-6.

<sup>183</sup> As noted supra at notes 170, 171, GCI identified the Alaska market as a separate geographic market. We also note that GCI has filed a petition seeking reconsideration of the AT&T Reclassification Order, in which it argues that the reclassification of AT&T does not apply to AT&T/Alascom, Inc. because AT&T/Alascom is still dominant in the Alaska market. See GCI petition for reconsideration or clarification of AT&T Reclassification Order (filed Nov. 22, 1995).

<sup>184</sup> See supra ¶ 29.

## 2. Geographic Market for BOC InterLATA Affiliates and Independent LECs

### a. Background

70. In the Non-Accounting Safeguards NPRM, we tentatively concluded that, if we adopt the approach proposed in the Interexchange NPRM, we should evaluate a BOC's point-to-point markets in which calls originate in-region separately from its point-to-point markets in which calls originate out-of-region, for purposes of determining whether BOC interLATA affiliates have market power in the provision of interstate, domestic, interLATA services.<sup>185</sup> Similarly, we tentatively concluded that we should evaluate an independent LEC's point-to-point markets in which calls originate in its local exchange areas separately from its markets in which calls originate outside those areas, for the purpose of determining whether an independent LEC possesses market power in the provision of interstate, domestic, interexchange services.<sup>186</sup>

### b. Comments

71. Several commenters support the Commission's tentative conclusion that it should evaluate a BOC's point-to-point markets in which calls originate in-region separately from its point-to-point markets in which calls originate out-of-region in order to determine whether a BOC interLATA affiliate possesses market power in-region.<sup>187</sup> CTA and LDDS argue that this approach is supported by the fact that Congress legislated different treatment for in-region and out-of-region BOC services.<sup>188</sup> Although LDDS agrees with the Commission's proposal to identify particular markets only where credible evidence of a lack of competition and a failure of geographic rate averaging to mitigate market power exists, LDDS argues that the Commission should find that, in light of BOC control over the origination and termination ends of nearly all interstate, long distance calls, the relevant geographic market for a BOC interLATA affiliate will be the entire region from which it provides long distance services, regardless of whether it is part of the region in which the BOC provides local exchange and exchange access service.<sup>189</sup> MCI contends that the approach proposed in the Non-Accounting Safeguards NPRM recognizes that there are

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<sup>185</sup> Non-Accounting Safeguards NPRM at ¶ 126.

<sup>186</sup> Id.

<sup>187</sup> See e.g., Sprint Aug. 15, 1996 Comments at 61-62; TRA Aug. 15, 1996 Comments at 24; CTA Aug. 15, 1996 Comments at 34; MCI Aug. 15, 1996 Comments at 59; LDDS Aug. 30, 1996 Reply at 12.

<sup>188</sup> CTA Aug. 15, 1996 Comments at 34; LDDS Aug. 30, 1996 Reply at 12-13.

<sup>189</sup> LDDS April 19, 1996 Comments at 6.



greater opportunities for cross-subsidization and anticompetitive conduct for interLATA service originating in a BOC's service region.<sup>190</sup> Regardless of the market definition, DOJ states that it is "not unreasonable" in this proceeding for the Commission to distinguish a BOC's provision of interexchange service outside its region from provision of such service within its region.<sup>191</sup> Sprint and the New York Public Service Department urge the Commission to recognize that mergers, acquisitions, and similar combinations by BOCs may require consideration of geographic markets more extensive than a BOC's own region.<sup>192</sup>

72. The BOCs generally oppose the approach proposed in the Non-Accounting Safeguards NPRM and contend that the Commission should treat domestic, interstate, interexchange services as a single national market for purposes of determining whether a BOC interLATA affiliate possesses in-region market power.<sup>193</sup> BellSouth and USTA contend that all competing carriers should be subject to the same standards, including the same relevant market definitions, absent compelling reasons for disparate treatment.<sup>194</sup> BellSouth and USTA argue that, given the BOCs' zero market share, the structural separation requirements and regulatory safeguards that apply to a BOC's provision of long distance services, and the comprehensive regulation of the BOCs' bottleneck facilities, the Commission's assumption that BOC interLATA affiliates may have market power over in-region interexchange services and therefore those services may need to be examined separately from out-of-region services is flawed.<sup>195</sup>

73. NYNEX contends that the fact that the BOCs are not likely to begin offering interexchange services with nationwide networks does not justify redefining the geographic market because many interexchange carriers also concentrate their offerings in particular regions.<sup>196</sup> NYNEX also asserts that the 1992 Merger Guidelines support a single,

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<sup>190</sup> MCI Aug. 15, 1996 Comments at 59.

<sup>191</sup> DOJ Aug. 30, 1996 Reply at 21.

<sup>192</sup> Sprint Aug. 15, 1996 Comments at 61-63; New York State Department of Public Service (NYDPS) Aug. 30, 1996 Comments at 7.

<sup>193</sup> Ameritech Aug. 15, 1996 Comments at 5; Bell Atlantic Aug. 15, 1996 Comments at 12; BellSouth Aug. 15, 1996 Comments at 40-41; NYNEX Aug. 15, 1996 Comments at 51-52; PacTel Aug. 15, 1996 Comments at 50-51.

<sup>194</sup> BellSouth April 19, 1996 Comments at 13, 16; BellSouth Aug. 15, 1996 Comments at 48; see USTA Aug. 29, 1996 Comments at 3.

<sup>195</sup> BellSouth Aug. 15, 1996 Comments at 45-46; USTA Aug. 15, 1996 Comments (Hausman Aff. at 7)

<sup>196</sup> NYNEX April 19, 1996 Comments at 6-7.

nationwide geographic market definition regardless of whether interexchange services provided by BOC interLATA affiliates originate in-region or out-of-region.<sup>197</sup> Bell Atlantic, BellSouth, and NYNEX argue that geographic rate averaging will prevent the BOCs from being able to raise prices selectively in targeted areas. Moreover, these parties allege that even if a BOC attempted to raise rates on any given route, other carriers would respond by offering lower rates because they would have sufficient capacity available on their existing networks to be able to carry the BOC customers that they would attract through lower prices.<sup>198</sup>

74. USTA argues that the Commission should not change the single, national geographic market definition in assessing the market power of independent LECs because: (1) the national scope of major telecommunications companies has increased over the years, not lessened, with the four largest IXCs controlling over 85 percent of the market; and (2) the national market is the relevant market for independent LECs, their competitors and the public, because interexchange service offerings are generally ubiquitous, not local or regional, and pricing, marketing, and networks are all national in scope.<sup>199</sup> USTA adds that customers generally purchase interexchange services under ubiquitous calling plans, not on a point-to-point basis.<sup>200</sup> According to USTA, although independent LECs provide local exchange services that are regional or local in scope, this does not change the national nature of the interexchange market because customers can choose from national, regional or local providers of long distance service.<sup>201</sup>

75. As noted above, AT&T asserts that the geographic market definition is irrelevant in determining whether the BOCs or independent LECs could abuse their power in the local market to impede interexchange competition.<sup>202</sup> AT&T contends that market definitions and market share analyses are unnecessary when the presence of market power can be proven directly, as it can here because of the BOCs' control of the local bottleneck, or where undisputed power in one market (*i.e.*, local services) can be leveraged to impede

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<sup>197</sup> NYNEX Aug. 15, 1996 Comments at 52

<sup>198</sup> BellSouth April 19, 1996 Comments at 17; Bell Atlantic April 19, 1996 Comments at 7; Bell Atlantic Aug. 15, 1996 Comments at 13-14; NYNEX Aug. 15, 1996 Comments at 53.

<sup>199</sup> USTA Aug. 29, 1996 Comments at 2-3 (Spulber Aff. at 5-8).

<sup>200</sup> Id. (Spulber Aff. at 6-7).

<sup>201</sup> Id. (Spulber Aff. at 7).

<sup>202</sup> AT&T Aug. 15, 1996 Comments at 61; see generally General Services Administration (GSA) April 19, 1996 Comments at 2, May 3, 1996 Reply at 3.

competition in a second market (*i.e.*, long distance).<sup>203</sup> AT&T also asserts, however, that "while interexchange services originating in a particular BOC's service area generally could not be a separate geographic market, a determination of the appropriate regulatory treatment of a BOC's (or independent LEC's) in-region interLATA services should focus on these areas."<sup>204</sup>

**c. Discussion**

76. In evaluating whether BOC interLATA affiliates and independent LECs possess market power in the interstate, domestic, long distance market, we conclude that we generally will follow the approach proposed in the Non-Accounting Safeguards NPRM. As discussed above, we disagree with those commenters that advocate using a single national geographic market definition. We conclude that a local exchange carrier's control of the local bottleneck constitutes credible evidence that there could be a lack of competitive performance in point-to-point markets that originate in-region. Because we expect that competitive conditions will be different for those point-to-point markets that originate in-region than for those point-to-point markets that originate out-of-region, we find that our analysis of market power should reflect this expectation.<sup>205</sup> Therefore, in determining whether BOC interLATA affiliates have market power in the provision of interstate, domestic, interLATA services, we conclude that calls originating from in-region point-to-point markets should be analyzed separately from calls originating from out-of-region point-to-point markets. Similarly, in determining whether independent LECs have market power in the provision of interstate, domestic, interexchange services, we conclude that calls originating in point-to-point markets within their local service areas should be analyzed separately from calls originating in point-to-point markets outside those areas.

77. We adopt this bifurcated analysis to determine whether a BOC or independent LEC, through improper cost allocation or discrimination, could use its market power in local exchange and exchange access services to disadvantage long-distance rivals of the BOC interLATA affiliate or independent LEC. Such improper cost allocation or discrimination might enable a BOC interLATA affiliate or independent LEC to obtain the ability profitably

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<sup>203</sup> AT&T Aug. 15, 1996 Comments at 61; see generally GSA April 19, 1996 Comments at 2, May 3, 1996 Reply at 3.

<sup>204</sup> AT&T Aug. 15, 1996 Comments at 62. USTA contends that AT&T's focus on the local exchange market is incorrect and would lead to the illogical conclusion that the BOCs should be dominant in the provision of information services, CPE, and cellular. USTA Aug. 30, 1996 Reply (Hausman Aff. at 1-3).

<sup>205</sup> In-region, a BOC's control over the local bottleneck may give it a competitive advantage that it does not have out-of-region, causing the BOC to compete differently in-region than out-of-region. Therefore, the competitive conditions in-region are likely to be different in-region than out-of-region.

to raise and sustain its price for in-region, interstate, domestic, long distance services above competitive levels by restricting its output of long distance services. We are not persuaded, moreover, that geographic rate averaging of interstate long distance services alone will necessarily suffice to offset the potential anticompetitive effects of a BOC's or independent LEC's use of the market power resulting from its control over local access facilities because if a BOC interLATA affiliate's or independent LEC's long distance customers are concentrated in one region, it may be profitable to raise prices above competitive levels, even if geographic rate averaging might cause it to lose market share outside that region.

78. We reject AT&T's contention that the geographic market definition is irrelevant in assessing whether BOC interLATA affiliates or independent LECs possess market power.<sup>206</sup> As discussed above, we conclude that a relevant geographic market must be defined in order to conduct an accurate assessment of market power. While we agree with AT&T that other factors are important in making our overall assessment of market power, we do not agree that we can avoid defining the relevant geographic market if we wish to achieve an accurate assessment of whether BOC interLATA affiliates or independent LECs possess market power in the long distance marketplace. Moreover, we further note that, in some cases, it may be necessary to focus specifically on the termination point because the local exchange carrier that serves the end-user customer will necessarily have market power with regard to that customer.

### 3. International Geographic Market for BOC InterLATA Affiliates and Independent LECs

79. In the Non-Accounting Safeguards NPRM, we tentatively concluded that, for purposes of assessing whether BOC interLATA affiliates or independent LECs could exercise market power in the international long distance marketplace, market power should be measured on a worldwide, rather than route-by-route, basis, except for routes on which the carriers are affiliated with foreign carriers in the destination market.<sup>207</sup> MCI, NYNEX and USTA agree with the Commission's tentative conclusion.<sup>208</sup>

80. In assessing whether BOC interLATA affiliates and independent LECs possess market power in the international long distance marketplace, we adopt our tentative conclusion, but clarify that we will examine aggregate data that encompasses all international

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<sup>206</sup> AT&T Aug. 15, 1996 Comments at 61-62.

<sup>207</sup> Non-Accounting Safeguards NPRM at ¶ 129.

<sup>208</sup> MCI Aug. 15, 1996 Comments at 59-60; NYNEX Aug. 15, 1996 Comments at 61; USTA Aug. 15, 1996 Comments at 43-44, n. 18.

point-to-point markets, unless there is credible evidence suggesting that there is or could be a lack of competition in one or more international point-to-point markets. Of course, as discussed above, we will examine international point-to-point markets that originate in-region separately from international point-to-point markets that originate out-of-region. We acknowledge that myriad factors, including whether a carrier controls 100 percent of the capacity of the U.S. half of a particular international point-to-point market, may affect our determination of whether each international point-to-point market has competitive characteristics that are sufficiently similar to other point-to-point markets in the international marketplace.<sup>209</sup> In such cases, it may be necessary to conduct a more particularized analysis and examine certain individual international point-to-point markets or groups of point-to-point markets separately. Because no such factors currently apply or, we believe, are likely to apply to any BOC interLATA affiliate or independent LEC, however, we find that each individual international point-to-point market exhibits similar competitive characteristics to all other international point-to-point markets. Therefore, it is unnecessary for us to conduct a separate analysis for each international point-to-point market, given the administrative burdens associated with such an inquiry. Our decision here to examine aggregate data that encompasses all international point-to-point markets does not modify our existing route-by-route approach to consider whether U.S. carriers affiliated with a foreign carrier should be regulated as dominant in the provision of international services because they are affiliated with a foreign carrier that exercises market power in a foreign market.

#### **IV. CLASSIFICATION OF BOC INTERLATA AFFILIATES AND INDEPENDENT LECS AS DOMINANT OR NON-DOMINANT CARRIERS IN THE PROVISION OF IN-REGION LONG DISTANCE SERVICES**

81. In this section, we consider whether we should continue the dominant carrier classification that under our rules would apply to the BOC interLATA affiliates in the provision of in-region, interstate, domestic, interLATA services.<sup>210</sup> In order to reclassify the BOC interLATA affiliates as non-dominant, our rules require us to conclude that they will not possess market power in the provision of those interLATA services in the relevant

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<sup>209</sup> In classifying AT&T as non-dominant in the provision of IMTS, we generally analyzed AT&T's market power on a worldwide basis as a surrogate for a route-by-route analysis, except a route-by-route analysis was employed to scrutinize those markets that have not supported entry by competing U.S. carriers. A route-by-route approach also was used to analyze the competitive impact of AT&T's affiliations and alliances with foreign carriers on particular U.S. international routes. In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service, Order, FCC 96-209, at ¶ 32 (rel. May 14, 1996).

<sup>210</sup> As previously discussed, for convenience, we use the term "BOC interLATA affiliates" to refer to the separate affiliates established by the BOCs, in conformance with section 272(a)(1), to provide in-region, interLATA services. See supra n. 12.

product and geographic markets.<sup>211</sup> We also consider whether we should modify the regulatory regime adopted in the Competitive Carrier Fifth Report and Order for the regulation of in-region, interstate, domestic, interexchange services provided by independent LECs. Finally, we consider whether we should apply the same regulatory classification to the BOC interLATA affiliates' and independent LECs' provision of in-region, international services as we adopt in this proceeding for their provision of in-region, interstate, domestic, long distance services.<sup>212</sup>

#### A. Classification of BOC InterLATA Affiliates

82. We conclude that the requirements established by, and the rules implemented pursuant to, sections 271 and 272, together with other existing rules, sufficiently limit a BOC's ability to use its market power in the local exchange or exchange access markets to enable its interLATA affiliate profitably to raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting the affiliate's own output. We therefore classify the BOCs' section 272 interLATA affiliates as non-dominant in the provision of these services. We also conclude that we should apply the same regulatory classification to the BOC interLATA affiliates' provision of in-region, international services as we adopt for their provision of in-region, interstate, domestic, interLATA services.

##### 1. Definition of Market Power and the Limits of Dominant Carrier Regulation

###### a. Background

83. In the Non-Accounting Safeguards NPRM, we noted that there are two ways in which a carrier can profitably raise and sustain prices above competitive levels and

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<sup>211</sup> Our analysis of whether the BOC interLATA affiliates should be classified as dominant or non-dominant in the provision of in-region, interstate, domestic, interLATA services has no bearing on the determination of whether a BOC interLATA affiliate has satisfied the requirements of section 271(d)(3), and it should not to be interpreted as prejudging such determinations in any way.

<sup>212</sup> This proceeding does not modify the Commission's separate framework, adopted in the International Services Order and Foreign Carrier Entry Order, for regulating United States international carriers (including BOC interLATA affiliates or independent LECs) as dominant on routes where an affiliated foreign carrier has the ability to discriminate in favor of its U.S. affiliate through control of bottleneck services or facilities in the foreign destination market. See *infra* ¶ 139.

thereby exercise market power.<sup>213</sup> First, a carrier may be able to raise prices by restricting its own output (which usually requires a large market share); second, a carrier may be able to raise prices by increasing its rivals' costs or by restricting its rivals' output through the carrier's control of an essential input, such as access to bottleneck facilities, that its rivals need to offer their services.<sup>214</sup> We sought comment on whether the BOC interLATA affiliates should be classified as dominant carriers in the provision of in-region, interstate, domestic, interLATA services under our rules only if we find that the affiliates have the ability to raise prices of those services by restricting their own output, or whether we should also classify the affiliates as dominant if the BOCs have the ability to raise prices by raising the costs of their affiliates' interLATA rivals.<sup>215</sup>

**b. Comments**

84. Most commenters that address this issue, including DOJ, argue that the BOC interLATA affiliates should be classified as dominant only if they have the ability to raise the prices of interLATA services by restricting their own output.<sup>216</sup> MCI and AT&T contend, however, that we should also classify a BOC interLATA affiliate as dominant if it (or its BOC parent) has the ability to raise the costs or restrict the output of the affiliate's rivals through control of an essential input, such as exchange access, or the ability to raise the prices paid by the affiliate and its rivals for exchange access.<sup>217</sup> MCI claims that, even if consumer prices are not raised immediately, a BOC's ability to impose excessive costs on or to restrict essential inputs to its interexchange rivals presents a long-run harm to competition because it will make the BOC's rivals weaker competitors, and thereby reduce their output

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<sup>213</sup> Non-Accounting Safeguards NPRM at ¶ 131. For convenience, we refer, as we did in the Notice, to a carrier's ability to engage in such a strategy as the ability to "raise prices."

<sup>214</sup> Id. We also noted that economists have recognized these different ways to exercise market power by distinguishing between "Stiglerian" market power, which is the ability of a firm profitably to raise and sustain its price significantly above the competitive level by restricting its own output, and "Bainian" market power, which is the ability of a firm profitably to raise and sustain its price significantly above the competitive level by raising its rivals' costs and thereby causing the rivals to restrain their output. T.G. Krattenmaker, R.H. Lande, and S.C. Salop, Monopoly Power and Market Power in Antitrust Law, 76 Geo. L.J. 241, 249-53 (1987).

<sup>215</sup> Non-Accounting Safeguards NPRM at ¶ 132.

<sup>216</sup> DOJ Aug. 30, 1996 Reply at 16; USTA Aug. 15, 1996 Comments at 47; USTA Aug. 30, 1996 Reply, Hausman Aff. at 2; U S West Aug. 15, 1996 Comments at 46; Citizens for a Sound Economy Foundation (CSE) Aug. 30, 1996 Reply at 6-8.

<sup>217</sup> MCI Aug. 15, 1996 Comments at 60-61; AT&T Aug. 15, 1996 Comments at 65.

and make consumer price increases inevitable.<sup>218</sup> MCI asserts that raising rivals' costs is, in fact, likely to result in an increase in the BOC interLATA affiliate's rates, which could be prevented by dominant carrier regulation.<sup>219</sup>

c. Discussion

85. We conclude that the BOC interLATA affiliates should be classified as dominant carriers in the provision of in-region, interstate, domestic, interLATA services only if the affiliates have the ability to raise prices of those services by restricting their own output of those services. As we stated in the Notice, we believe that our dominant carrier regulations are generally designed to prevent a carrier from raising prices by restricting its output rather than to prevent a carrier from raising its prices by raising its rivals' costs.<sup>220</sup> In fact, these regulations were adopted at a time when AT&T was essentially a monopoly provider of domestic long distance services.<sup>221</sup> As discussed below, application of these regulations to a carrier that does not have the ability to raise long distance prices by restricting its own output could lead to incongruous results.<sup>222</sup>

86. Even AT&T acknowledges that at least some of the dominant carrier regulations, such as price ceilings and more stringent section 214 requirements, are not designed to address the potential problems associated with BOC entry into competitive markets.<sup>223</sup> For example, although we recognize, as discussed below, that there are circumstances in which price cap regulation (including price floors) of a BOC interLATA affiliate's rates might decrease a BOC's ability to engage in anticompetitive conduct,<sup>224</sup> we

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<sup>218</sup> MCI Aug. 15, 1996 Comments at 61-62.

<sup>219</sup> Id. at 62-63.

<sup>220</sup> Non-Accounting Safeguards NPRM at ¶ 132. Accord NYNEX Aug. 15, 1996 Comments at 51; USTA Aug. 15, 1996 Comments at 47; DOJ Aug. 30, 1996 Reply at 16. As noted in the NPRM, the definitions of market power cited by the Commission in the Competitive Carrier Fourth Report and Order referred to the concept of a carrier raising price by restricting its own output. Non-Accounting Safeguards NPRM at ¶ 132 (citing Competitive Carrier Fourth Report and Order, 95 FCC 2d at 558, ¶¶ 7, 8).

<sup>221</sup> AT&T Reclassification Order, 11 FCC Rcd at 3308, ¶ 69.

<sup>222</sup> Bell Atlantic Aug. 15, 1996 Comments at 19 (dominant carrier regulation would not address any of the concerns raised in the Notice); USTA Aug. 30, 1996 Reply at 23-24.

<sup>223</sup> AT&T Aug. 15, 1996 Comments at 65-66. Accord DOJ Aug. 30, 1996 Reply at 27.

<sup>224</sup> We also conclude below that price cap regulation of the BOCs' exchange access services will reduce the BOCs' incentive to misallocate the costs of their affiliates' interLATA services. See infra ¶ 106.



believe that in this situation the disadvantages of price cap regulation outweigh its benefits. Similarly, we question whether more stringent section 214 requirements would be an efficient means of addressing the concerns raised by BOC entry. Congress enacted the facilities-authorization requirements in section 214 and subsequent amendments primarily to prevent investment in unnecessary new plant by rate-base regulated common carriers and to bar service discontinuance in areas served by a single carrier.<sup>225</sup> Because we previously have found that markets for long distance services are substantially competitive in most areas, marketplace forces should effectively deter carriers that face competition from engaging in the practices that Congress sought to address through the section 214 requirements. For example, a carrier facing competition lacks the incentive to invest in unneeded facilities, because it cannot extract additional revenue from its long distance customers to recoup the cost of those facilities.<sup>226</sup> If such a carrier discontinues service in an area where it faces competition, its customers could turn to the carrier's competitors for service. Because marketplace forces generally eliminate the need for regulatory requirements imposed by section 214, we have granted a blanket section 214 authorization to non-dominant carriers such that they no longer must obtain prior approval to provide domestic long distance service or add new facilities and we impose less stringent requirements on non-dominant carriers that are discontinuing service.<sup>227</sup>

87. We recognize that certain aspects of dominant carrier regulation might constrain a BOC's ability to raise the costs of its affiliate's interLATA rivals or engage in other anticompetitive conduct.<sup>228</sup> For example, requiring a BOC interLATA affiliate to file its tariffs with advance notice and cost support data might help to detect and prevent predatory pricing, particularly if coupled with a price floor on the affiliate's interLATA

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<sup>225</sup> See Competitive Carrier First Report and Order, 85 FCC 2d at 39, ¶ 114. See also H. Averch and L. L. Johnson, Behavior of the Firm under Regulatory Constraint, 52 Amer. Econ. Rev. 1053 (1962) (a firm under rate of return regulation has an incentive to invest in more than the efficient amount of plant in order to increase the value of its rate base).

<sup>226</sup> Id. at 39, ¶ 114.

<sup>227</sup> 47 C.F.R. §§ 63.07, 63.71. Section 63.07 requires non-dominant carriers to report the acquisition or construction of initial or additional circuits to the Commission on a semi-annual basis, while section 63.71 imposes certain notification requirements on non-dominant carriers that plan to reduce, impair, or discontinue service. We recognize that, for certain areas, such as those served by a single interexchange carrier or where equal access has not been implemented, it may still be appropriate for the Commission to review a carrier's proposal to discontinue service.

<sup>228</sup> See also Time Warner Aug. 15, 1996 Comments at 39-40 (classifying BOC interLATA affiliates as dominant would provide a means to monitor BOC compliance with nondiscrimination requirements and the section 271 checklist).